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Dow Theory Letters

"The Market as Interpreted under the Dow Theory"

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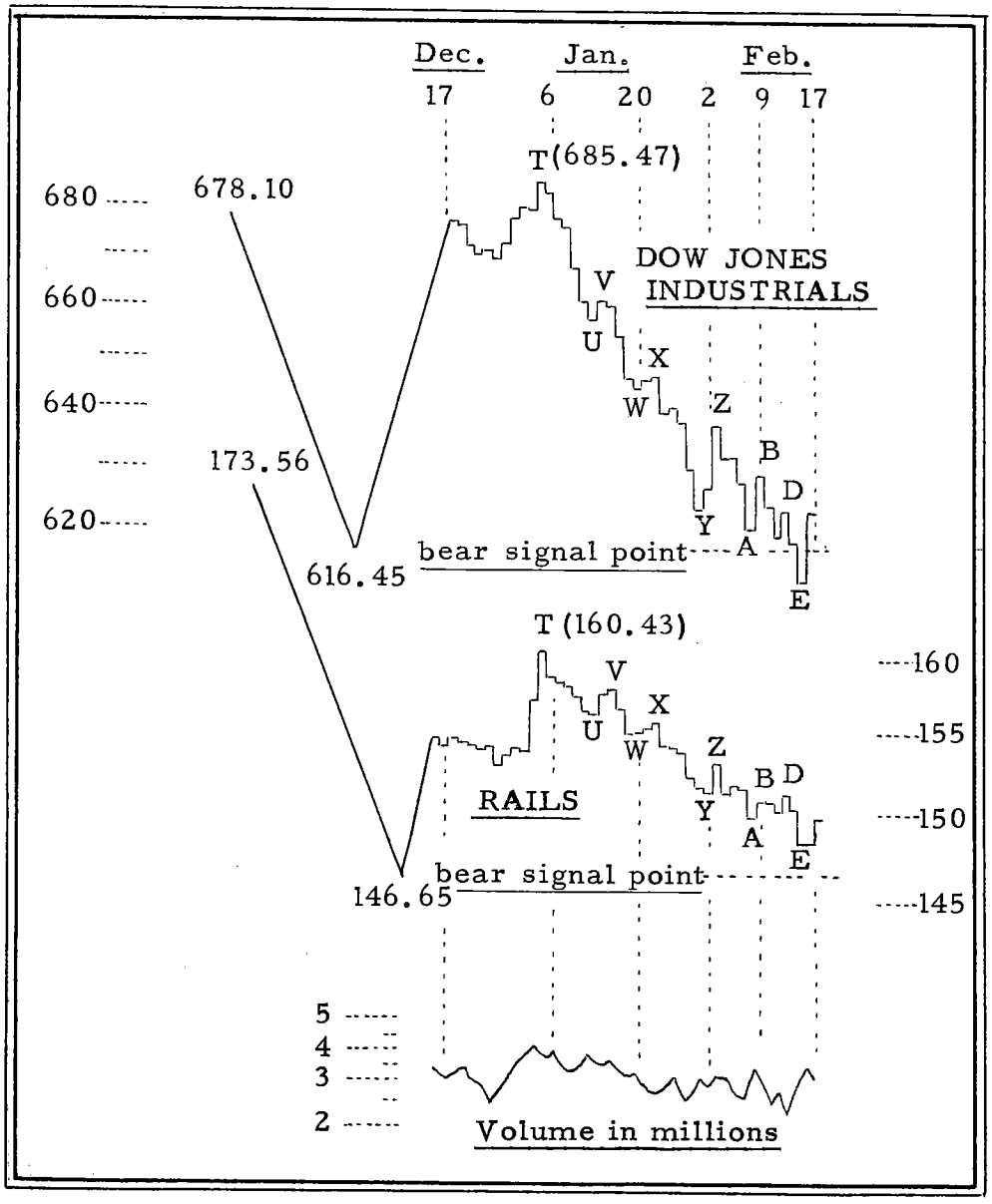
NEUTRAL CORNER? For a market "soothsayer", the struggle to remain objective and unemotional is a most difficult one. Having sold my own stock holdings at much higher levels, I am now in a position to buy back at substantial discounts, should the occasion arise. I do not hold a short position, and from the standpoint of personal investments, I am therefore not committed to the bear side.

My December article in Barron's ("Tell-Tale Ratio") suggested that the market was vulnerable, and the subsequent 74 point drop has already vindicated this early opinion. The more recent Barron's article (February 8) drew attention to the bear points without attempting to predict or suggest that those points would be violated. Should the bull market eventually be reaffirmed, no one can denounce Dow's Theory since it has insisted (at least as of this writing) that there has been no bear signal. If a bear signal is given there may be comments about "that Dow Theorist in Barron's", but I have not forgotten Hamilton's words: "....the prophet of calamity will make himself hated in any case, and hated all the more if his predictions come true."



Wall Street and most services are emotionally committed to the bull side, the more so since twelve million Americans now own stocks, and they do not wish to be reminded of the fact that the other side of the mountain slopes down. "We are a childish people," observed Hamilton; "we believe what we want to believe." This Service turned moderately bearish last July and August, but despite this, circulation has increased perhaps 40% since then. More important to me, only five cancellations

have been received here over the last eight months. I have little doubt that if I had remained bullish, circulation could have been increased even more, but cancellations would also have been considerably higher.

My present (and perhaps unpopular) attitude might best be described by the following quote from Rhea: "Any person who tries to be in the market at all times is almost certain to lose money, for there are periods when even the most skillful trader is in doubt as to what will happen. A good market axiom is, 'When in doubt, do nothing'." Lest there be any misunderstanding, I might also add that I do not now know of a single seasoned Dow Theorist who feels confident of the next important turn of events.

THE MARKET. One of the most breathtaking market dramas of recent years was played last week (February 17). Industrials had violated their 616.45 primary bear point on February 16, and in so doing, had given one half of a bear signal. Half a bear signal, as subscribers know, is no better than none. But on February 17 heavy volume drove both Averages sharply lower; at mid-day the Dow Jones ticker announced that the Rail Average was exactly 146.65. Immediately a heavy tide of buying came into the market, and this buying continued to the close. The final figures showed Rails up .05 on the day and Industrials up 2.22. A bear market signal had thus been averted.

In the vast majority of cases when one Average will not confirm the weakness of the other in a downside penetration it also proves to be the stronger Average on the next advance. For instance, last year the Rails appeared to be the weaker Average; in November they provided half a bear signal by violating their earlier September lows. Industrials refused to confirm this Rail weakness, and on the ensuing rise the senior Average surged to a new bull market high. The situation is now reversed, and it is the Rails that have refused to confirm Industrial weakness. Under these circumstances we would expect to see Rails lead the way on the next rally.

This is a fine point, but it is worth watching. The question now is -- will informed investors buy the Rails or are we witnessing distribution in the carrier Average? The first hint of Rail distribution could be sluggishness in the Rails on any advance from this area. Since Rails were supported at the crucial bear signal point, I would expect (in a bull market) that Rails should give a good performance on the upside. If the Rails now are being distributed under the disguise of a rebound in Industrials (and this is often the case), then we will see signs of it in the price structure.

If we have been in a bull market reaction since the T highs, then the chances are that we have already seen the lows of the reaction (E -- Industrials 611.33, Rails 148.37). As explained in the last Letter, most bull market reactions end with a "dragging sideways" movement, during which period volume quiets down and informed investors begin accumulating stocks. A series of two or more upward zig-zags appearing from such a base would imply that the secondary trend has turned up, and the usual "buy-spot" (Letter 93) will, in all likelihood, have appeared. Prices will then work higher, and the two Averages will eventually reaffirm the primary bull trend by bettering their upside primary points (Industrials 685.47, Rails 173.56).

If the tide has turned down, then the bear points (now 146.65 on Rails alone) will be cracked before the highs are bettered. Assuming we are now in a bear market, there is still the possibility that the Averages will retrace the normal 1/3 to 2/3 of the losses sustained since the T points before giving a bear signal. I would also expect, if we are in a bear market, that such an upward correction would be fairly rapid and might come from no visible base or area of re-accumulation. A good part of any such retracement might be triggered by short covering and floor traders jumping in as they throw their weight behind the technical rally.

The price movement over the last few weeks has been wild and erratic (which is normal when primary points are approached), but the overall pattern is still one of descending